MINUTES
of the
SECOND MEETING
of the
REVENUE STABILIZATION AND TAX POLICY COMMITTEE

July 7-9, 2004
Zia Conference Center, San Juan College
Farmington

The second meeting of the Revenue Stabilization and Tax Policy Committee (RSTPC) for the 2004 interim was called to order by Representative Donald L. Whitaker, chair, on Wednesday, July 7, 2004, at 10:20 a.m. at the Zia Conference Center of San Juan College in Farmington.

PRESENT
Rep. Donald L. Whitaker, Chair
Sen. John Arthur Smith, Vice Chair (7/7)
Rep. Janice E. Arnold-Jones
Sen. Mark Boitano (7/8-7/9)
Sen. Carlos R. Cisneros
Rep. Anna M. Crook
Rep. Roberto "Bobby" J. Gonzales
Sen. Timothy Z. Jennings
Rep. Ben Lujan (7/7-7/8)
Sen. William E. Sharer
Rep. Daniel P. Silva
Sen. H. Diane Snyder (7/7-7/8)
Rep. Thomas C. Taylor

ABSENT
Sen. Sue Wilson Beffort
Sen. Joseph A. Fidel
Rep. George J. Hanosh
Sen. Roman M. Maes, III
Rep. James G. Taylor

Designees
Sen. Cisco McSorley *(designee for Sen. Roman M. Maes, III, on 7/7)*

(Attendance dates are noted for members not present for the entire meeting.)

Staff
Amy Chavez and Pam Ray

Guests
The guest list is in the meeting file.

Copies of all written testimony are in the meeting file.

Wednesday, July 7

APPROVAL OF MINUTES

The committee unanimously approved the minutes of its first meeting held on June 18, 2004 in Santa Fe.

OPENING REMARKS BY CITY OF FARMINGTON AND SAN JUAN COUNTY OFFICIALS

Bill Standley, mayor of the City of Farmington, Steve Neville, chairman of the San Juan County Commission, and Dr. Carol Spencer, president of San Juan Community College, provided opening remarks at the second meeting of the RSTPC. Mayor Standley discussed the growth in population in the City of Farmington and in San Juan County. Mayor Standley noted that Farmington has a population of 37,000 while San Juan County has a population of about 117,000. Mayor Standley highlighted the progress of city projects, including a $13 million three-phase expansion of a Farmington wastewater treatment plant, expansion of Indian Hills Boulevard and construction of a retail transportation, medical and education center.

Commissioner Neville discussed the local option taxes that were recently passed in San Juan County, including a local option hospital tax and a local option emergency services tax. Commissioner Neville noted that some local option funding will be used to expand the San Juan Adult Detention Center and to complete a juvenile services center, which will provide residential substance abuse treatment and shelter beds for youth.

NATURAL GAS DEVELOPMENT IN THE JICARILLA RANGER DISTRICT OF THE CARSON NATIONAL FOREST

John Zent, general manager of the San Juan Division of Burlington Resources, Inc., discussed the Carson National Forest's release of a Draft Environmental Impact Statement (DEIS) intended to support proposed changes to its forest plan. During the last legislative session, the house of representatives passed House Memorial 6 requesting the Carson National Forest supervisor to withdraw proposed changes to the Carson National Forest management plan for the Jicarilla Ranger District. The forest service retracted the DEIS earlier this year.

Mr. Zent stated that if the DEIS had not been withdrawn, it would have adversely impacted oil and gas development in the Jicarilla Ranger District and the economic benefits that come with such development. The impact statement would have prevented about 68 percent of planned new drilling for oil and gas development. Mr. Zent stated that the prevention of additional development would have resulted in an 11 percent reduction in annual gas well jobs in the district. In 2001, the state received $20,424,320 in revenues from gas production in the Jicarilla Ranger District and Mr. Zent stated that a significant share of those revenues were distributed to local, county and other governmental units to fund schools and other programs. Mr. Zent stated that changes proposed by Carson National Forest to its forest plan would have unnecessarily restricted domestic energy development and undermined the Bureau of Land Management's efforts to manage mineral resources. Mr. Zent added that the DEIS was rightfully retracted because the DEIS was based on flawed assumptions and internal errors. Although the

DEIS was retracted, Mr. Zent stressed that the oil and gas industry will work with the forest service to develop oil and gas resources in the Jicarilla Ranger District in an environmentally sound manner.

Mark Catron, planning staff officer with the Carson National Forest, stated that the Carson National Forest Service Office plans to conduct a study to determine how various stakeholders might be affected by further development in the Jicarilla Ranger District. The office also plans to review the original data that served as the basis for the DEIS that was retracted. The possibility of reclamation and technological developments in the area of water quality analysis will be considered when the forest service conducts its study. Mr. Catron stressed that a major area of concern to the forest service will continue to be protection of cultural resources and migratory elk and deer herds in the Jicarilla Ranger District.

LOCAL GROSS RECEIPTS AND COMPENSATING TAX ISSUES

New Mexico Municipal League (NMML) President Bill Standley and NMML Executive Director Bill Fulginiti presented several tax policy issues to the committee. Mr. Standley and Mr. Fulginiti addressed changes to the state's tax system, including personal income tax reductions enacted in 2003, a 70-cent increase in the cigarette tax and the repeal of the gross receipts tax on food and health practitioners. Mr. Fulginiti thanked the legislature and the governor for holding municipalities and counties harmless from the elimination of the gross receipts tax on food and health practitioners. Mr. Fulginiti also discussed the repeal of the municipal tax credit of one-half percent, which financed the removal of the gross receipts tax on food and health practitioners and the hold harmless provision for local governments.

Mr. Fulginiti discussed bills that the NMML proposes for adoption by the RSTPC for introduction during the 2005 legislative session. First, to make tax information available to local officials, the NMML proposes the reintroduction of House Bill 924 from the 1995 legislative session. Mr. Fulginiti stated that municipalities have encountered difficulties in assessing the accuracy of distributions from the Taxation and Revenue Department (TRD) and claimed that wide fluctuations in distributions and adjustments and the inability of municipalities to obtain tax information led to a lack of trust in the department. With the new deductions for food and health practitioners, the NMML concluded that it is necessary for municipalities to obtain accurate tax information from TRD. NMML proposes that the law should be amended to permit a designated person in a municipality to request and receive tax information so that local officials could assist the department with the assurance of the accuracy of its distributions.

The NMML also proposes the removal of the sunset provision from Section 7-19D-12 NMSA 1978, which permits municipalities to enact an ordinance to impose a capital outlay gross receipts tax at a rate of one-fourth percent. The statutory authorization of municipalities to impose the tax sunsets on July 1, 2005. Mr. Fulginiti stated that municipalities need additional time to enact the tax because they are required to enact all other local option gross receipts tax increments before they can pass a referendum for a capital outlay gross receipts tax. In addition, municipalities might need more time to enact the capital outlay gross receipts tax because the repeal of the municipal tax credit will increase the overall rate of the gross receipts tax by one-half percent on January 1, 2005, thus complicating efforts to pass referendums for local taxes.

Mr. Fulginiti further discussed NMML's desire for the committee to reintroduce House Bill 37 from the previous legislative session. The bill would trade a part of the municipal distribution of gross receipts tax for a distribution of personal income tax to diversify revenue sources for municipalities. According to NMML, municipalities receive over 74 percent of their revenues from gross receipts taxes. Mr. Fulginiti explained that relying so heavily upon one source of revenue is dangerous when the economy slows down. Municipalities might benefit from receiving a different source of revenue, such as personal income tax revenue, as a means to minimize the risk inherent in relying on one method of taxation.

Mr. Fulginiti also discussed the differences in gross receipts tax rates and compensating tax rates on New Mexico businesses. He stated that as long as e-commerce, mail order and television sales grow and as long as municipalities are by law mostly dependent on gross receipts tax revenue, municipalities and cities could lose about $48 billion in revenue, while the state could lose $120 million. Mr. Fulginiti stated that to take advantage of the shift to remote commerce, the legislature should repeal the section of law that prohibits TRD from collecting compensating taxes on residential purchases. He further suggested that to allow cities to recover the loss of the gross receipts tax, the legislature should permit municipalities to enact local option compensating taxes in the same amount as the local option gross receipts tax.

TAXATION AND REVENUE DEPARTMENT PROPOSED LEGISLATION

The TRD proposes two bills for adoption by the committee and for introduction to the 2005 legislature. Richard Anklam, assistant secretary and director of tax policy, and Valdean Severson, bureau chief of the Oil and Gas Section of the Revenue Processing Division, TRD, proposed that the committee adopt a bill to amend state law to include helium for taxation under the Oil and Gas Severance Tax Act, Oil and Gas Conservation Tax Act, Oil and Gas Emergency School Tax Act, Oil and Gas Ad Valorem Production Tax Act and the Oil and Gas Production Equipment Ad Valorem Tax Act. The purpose of the proposed legislation is to tax helium in a manner consistent with other gases, as is done in states that currently produce helium on a commercial basis. Proponents argue it is best to add helium to the severance taxes, as competing states do, before significant commercial activity is underway in New Mexico.

Assistant Secretary Anklam, Alvan Romero, chief of the Tax Fraud Unit, and Charles Williamson, attorney, TRD, proposed that the committee adopt a bill to establish a tax fraud investigations division to investigate possible criminal violations of the revenue laws of the state. TRD officials believe that the proposed statute could provide an important enforcement tool to prosecute cases of criminal fraud in the state. Successful prosecution requires highly specialized knowledge, investigative techniques and experience. TRD asserts that the creation of the new division will enhance the state's ability to successfully prosecute these types of crimes.

The meeting recessed for the day at approximately 3:45 p.m.

Thursday, July 8

EXTENDED HOURS FOR OPERATION OF GAMING MACHINES AT RACETRACK CASINOS

Representatives from racetracks throughout the state discussed their desire to extend hours for operation of gaming machines at racetrack casinos. Representatives of Sunray Park in Farmington stated that House Bill 65, which did not pass during the last legislative session, would have helped the racetrack industry and could have led to increased employment. Byron Campbell, general manager of Sunray Park, discussed the need to replace outdated machines. He said that at Sunray Park, headcounts at the casino have dropped by seven percent. Although horse race simulcast business has increased, slot operations remain an essential element of racetrack business success. He stated that old machines must be replaced to maintain the success of racetrack casinos. Machine replacement could cost up to $5.5 million. Extending gaming machine hours would help alleviate some of the burdens facing racetrack casinos in the next few years.

Joe Kupfer, representing Zia Park in Hobbs and Ruidoso Park in Ruidoso, stated that Zia Park and Ruidoso Park are aiming to interact more with the business community as a means of promoting racing industry growth. Mr. Kupfer stated that racetracks such as Zia Park and Ruidoso Park hope to attract visitors to stay overnight in the cities and towns in which racetracks are located. Extension of gaming hours might encourage visitors to stay overnight. He estimated that extension of gaming hours could increase racetrack revenues by 10 percent.

Scott Scanland, spokesperson for Sunland Park Racetrack in Sunland Park, added that, $50 million of New Mexico tax revenue is currently attributable to racetrack revenues. He argued that extending hours will ultimately benefit state funds. He stated that the addition of gaming machines to racetrack casinos has improved racetrack purses and the quality of racing in New Mexico. Expansion of gaming hours would increase racing industry revenue and thus provide additional tax revenue to the state.

The committee discussed the benefits of permitting extended gaming machine hours on racetracks, but also acknowledged that the state should continue to negotiate with tribes before any action is taken.

UNINSURED EMPLOYERS' FUND

Alan Varela, director of the Workers' Compensation Administration (WCA), and Richard J. Crollet, Esq., Uninsured Employers' Fund administrator, provided the committee with information regarding the Richard J. Crollet, Esq., Uninsured Employers' Fund and its administration. The fund is comprised of uninsured employers' fees and is used by the WCA to pay workers' compensation benefits to a person entitled to the benefits when that person's employer has failed to maintain workers' compensation coverage because of fraud, misconduct or other failure to insure or otherwise make compensation payments. Mr. Crollet stated that since November 2003, he has received 33 claims. The average turnaround time from receipt of an uninsured employers' claim to issuance of eligibility determination is five days. The statutory minimum turnaround time is 15 days. Twenty-five of the claims have been determined in favor of the employer. As of June 30, 2004, 19 claims eligibility determinations have been finalized and forwarded to the Uninsured Employers' Fund insurance carrier for payment of benefits.

The committee asked Mr. Varela and Mr. Crollet specific questions regarding workers' compensation coverage requirements, claims filed with the WCA and the sufficiency of the fund to pay the claims filed.

STATE AND LOCAL TAXES ON OIL AND GAS PRODUCTION IN NEW MEXICO

Dr. Tom Clifford, chief economist, TRD, and Kirk Muncrief, senior economist, TRD Tax Research Office, provided the committee with an overview of state and local taxes on oil and gas production in New Mexico. TRD estimates that taxes and royalties on crude oil and natural gas production have contributed between 13 percent and 16 percent of general fund revenues. When non-general fund revenues are included, almost $1.2 billion in state revenues were estimated to be derived from oil and gas production in the state during fiscal year 2004.

In addition to state taxes, Dr. Clifford stated that significant amounts of local revenue are collected from oil and gas production. In recent years, ad valorem taxes on oil and gas production have generated approximately $100 million per year for certain local governments. In addition to direct tax and royalty revenues, oil and gas production provides the economic base for significant amounts of personal income tax, corporate income tax and gross receipts tax collections. The state also benefits from interest earnings from the Land Grant Permanent Fund and the Severance Tax Permanent Fund, the corpus of which is primarily derived from oil and gas production in prior years.

Dr. Clifford further discussed the statutory and effective tax rates for oil and gas production-related taxes, incentive rates provided for certain categories of oil and gas production and local oil and gas production taxes.

Dr. Clifford provided the committee with projections for oil- and gas-related revenues. Dr. Clifford highlighted the volatility in the natural gas market as a factor that will affect the revenue outlook in the future. TRD studies show that New Mexico natural gas prices have varied from a low of $2.00 to a high of over $8.00 per million cubic feet (mcf). The consensus revenue projection for fiscal year 2005 estimates that the average price of natural gas will be $4.00 per mcf. The oil price for 2005 is projected at $26.00 per barrel. The volatility of gas prices proportionately affects state revenue. General fund revenue increases by $1.2 million for each additional cent in the average annual natural gas price. Revenue increases by $4 million for each additional dollar in the annual average crude oil price.

Volumes of natural gas and crude oil production are also a factor in state oil- and gas-related revenues. Volumes have steadily declined during the past few years. Since January 2000, volumes have decreased by approximately 7 percent. TRD projects that natural gas volumes will continue to decline at one percent to two percent per year, while oil production is projected to decline at a similar rate. Oil production has declined by 1.2 percent each of the last four years.

OIL AND GAS TAX REVIEW AND PROJECTIONS

Bob Gallagher, president of the New Mexico Oil and Gas Association, explained the different taxes on oil and gas production in New Mexico. Mr. Gallagher explained that the severance tax is a tax on all oil and gas that is severed and sold. The tax rate is 3.75 percent of the taxable value, as determined by TRD, at the first point of sale. The severance tax on crude oil and natural gas is distributed to the Severance Tax Bonding Fund.

Mr. Gallager explained that the emergency school tax is a privilege tax on every person severing oil and other liquid hydrocarbons, carbon dioxide and natural gas for New Mexico. The tax rate of 3.15 percent applies to crude oil, other liquid hydrocarbons and carbon dioxide and four percent for natural gas. The tax is levied on the value of the product, as determined by TRD, at the first point of sale. Revenues derived from the emergency school tax are distributed to general fund and are paid in lieu of gross receipts tax. Mr. Gallagher stated that recent attempts to increase the emergency school tax on crude oil by .85 percent would generate an additional $12 million to $15 million in tax revenue for the state, but would also cost the state additional drilling. According to Mr. Gallagher, a .85 percent increase in the tax could prevent development of 12 new wells in the state.

The conservation tax applies to all products that are severed and sold. The tax rate, a percentage of the taxable value of sold products, varies with the unencumbered balance in New Mexico's Oil and Gas Reclamation Fund. The reclamation fund was set up to plug and reclaim well sites considered "abandoned" when the owner of the well cannot be found and in the 2003 session was expanded to include $350,000 for energy education.

The conservation tax rate is .0019 percent of the taxable value of sold products if the fund falls below $500,000. In the event the unencumbered balance in the Oil and Gas Reclamation Fund equals or exceeds $1 million for any one-month period, the rate of the tax becomes .0018 percent. Any excess of the $1,350,000 in the reclamation fund goes to the general fund. When the balance of the reclamation fund is equal to or falls below $500,000, the higher rate of .0019 percent applies.

The natural gas processors tax is levied solely on processors for the privilege of operating a natural gas processing plant in New Mexico. The tax is imposed on the amount of MMBTU's of natural gas delivered to the processor at the inlet of the natural gas processing plant. Proceeds from the natural gas processors tax goes to the general fund.

Mr. Gallagher concluded that although oil and gas production taxes produce much state revenue, the legislature should be cautious about raising taxes to a degree to which oil and gas companies are discouraged from developing further in New Mexico or are driven from the state due to the increased costs of business associated with oil and gas tax increases.

SAN JUAN ECONOMIC DEVELOPMENT SERVICE

Margaret McDaniel, executive director of the San Juan Economic Development Service, expressed appreciation to the committee and the legislature for its support of the San Juan

Economic Development Department Job Training Incentive Program. In fiscal year 2004, the program funded 41 projects and created 1,506 jobs. Program goals include support of local businesses, job creation, recruitment of new businesses and the development of work force skills.

The meeting recessed for the day at approximately 3:45 p.m.

Friday, July 9

LOCAL DWI GRANT FUND AND ADMINISTRATION

Joyce Johnson, bureau chief, and Alicia Ortiz, auditor, from the Special Programs Bureau of the Local Government Division (LGD) of the Department of Finance and Administration (DFA) provided an overview of the Local DWI Grant Program. They explained that the program was established to make grant and distribution funding available to counties and municipalities to prevent or reduce the incidence of DWI, alcoholism and alcohol abuse throughout the state. The program is funded by grant allocations, distributions and statutory detoxification grants. Overall, in fiscal year 2005, 77.93 percent of program funding was allocated to treatment in 33 counties. DWI grant programs funded by the Local DWI Grant Fund entered into 219 subcontracts to provide treatment, compliance monitoring, screening and prevention services. The programs also funded enforcement activities in cooperation with county, city and tribal police department, screened 10,067 DWI offenders and funded 14 teen court programs. The programs further implemented alternative sentencing services in 17 counties.

In 2002, the Legislative Finance Committee (LFC) conducted an audit of the Local DWI Grant Program. In response to the LFC audit recommendations, the LGD has established a long-term strategic plan; revised the grant proposal scoring mechanism; strengthened the administrative handbook; strengthened program expenditure monitoring; established a site visit schedule; increased the number of DWI offenders screened; increased funding for program management and oversight; and developed a training curriculum for local program coordinators.

Ms. Johnson highlighted the progress of the Local DWI Program in reducing DWI fatalities. The National Highway Traffic Safety Administration reported that from 1982 to 2002, there was a 70 percent drop in alcohol-related fatalities per 100 million vehicle miles. According to the University of New Mexico Institute for Social Research and Division Government Research, deaths due to alcohol-related crashes for all three major ethnic groups decreased by 55 percent from the previous year in 2000.

Ms. Johnson stated that the Special Programs Bureau plans to work with the governor and his DWI coordinator to support local DWI programs. The bureau also plans to increase evidence-based prevention programming targeting youth, Hispanics and Native Americans. She also noted that the Local DWI Grant Council passed two resolutions to support local control of DWI grant revenues and to support restoration of DWI funding to local county DWI programs.

COMPACT AND GAMING ISSUES

Charles Dorame, chair of the New Mexico Indian Gaming Association, expressed opposition to the proposed extension of gaming machine hours at racetracks outside of the context of compact negotiations outlined by the Compact Negotiations Act. Mr. Dorame stated that the association views the proposal as a direct violation of the 2001 compacts, and as a result, tribes might be forced into litigation with the state. The association believes that any expansion of hours of operation at racetrack casinos would be an expansion of non-tribal gaming, which is in direct violation of the exclusivity clause of the compacts. Mr. Dorame added that the All Indian Pueblo Council takes the same position as the New Mexico Indian Gaming Association with respect to the issue. In 2003, the All Indian Pueblo Council passed a resolution stating that expanded gaming hours at racetracks might force the 2001 compact tribes to request new compact negotiations.

The committee adjourned at 12:05 p.m.